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AZ CORP COMMISSION
DOCKET CONTROL

Our File Number: 45365-00001

May 31, 2007

Yvette B. Kinsey
Administrative Law Judge
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Re: In the Matter of the Application of Navigator Telecommunications, LLC
Docket No. T-20398A-06-0346

Judge Kinsey:

At the hearing dated May 30, 2007, you requested Navigator file its 2006 audited financial statements as a late-filed exhibit. A copy of those financials statements is attached.

Very truly yours,

Mul Hall

Michael T. Hallam

MTH/jw
Enclosure

cc: Robin Mitchell (Legal Division)
Armando Fimbres (Utilities Division)

Arizona Corporation Commission
DOCKETED
MAY 31 2007
DOCKETED BY nr

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NAVIGATOR TELECOMMUNICATIONS, LLC

December 31, 2006 and 2005

Financial Statements

With

Independent Auditor's Report

MOORE STEPHENS FROST

CERTIFIED PUBLIC ACCOUNTANTS
A Professional Limited Company

425 West Capitol, Suite 3300
Little Rock, Arkansas 72201
501 376 9241 ◆ 800 766 9241
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Independent Auditor's Report

Management Committee and Members
Navigator Telecommunications, LLC
North Little Rock, Arkansas

We have audited the balance sheets of Navigator Telecommunications, LLC as of December 31, 2006 and 2005, and the related statements of operations, members' deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Navigator Telecommunications, LLC as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Moore Stephens Frost

Certified Public Accountants

Little Rock, Arkansas
March 6, 2007

NAVIGATOR TELECOMMUNICATIONS, LLC

Balance Sheets

December 31, 2006 and 2005

	2006	2005
Assets		
Current assets		
Cash	$ 327,768	$ 312,137
Restricted cash	150,000	110,000
Trade accounts receivable, net of allowance for doubtful accounts of $546,781 and $584,287 in 2006 and 2005, respectively	4,221,096	4,653,448
Prepaid expenses and other current assets	1,290,986	912,169
Total current assets	5,989,850	5,987,754
Property and equipment		
Telecommunication infrastructure	1,145,480	1,058,030
Less accumulated depreciation	(872,132)	(725,008)
Total property and equipment, net	273,348	333,022
Total assets	$ 6,263,198	$ 6,320,776
Liabilities and Members' Deficit		
Current liabilities		
Line of credit	$ 3,000,000	$ -
Notes payable		
Current portion	206,501	2,216,843
Related party - current portion	145,000	145,000
Trade accounts payable	5,197,510	4,769,385
Deferred revenue	1,106,486	959,812
Accrued liabilities	2,572,812	1,943,431
Customer deposits	104,891	176,954
Membership unit repurchase obligation	-	1,575,000
Total current liabilities	12,333,200	11,786,425
Long-term debt		
Notes payable		
Long-term	18,135	38,828
Related party - long-term	5,634,132	5,634,132
Total long-term debt	5,652,267	5,672,960
Members' deficit		
Members' deficit	(11,757,799)	(11,138,609)
Members' equity		
Contribution allowances	34,881	-
Membership unit rights	649	-
Total members' deficit	(11,722,269)	(11,138,609)
Total liabilities and members' deficit	$ 6,263,198	$ 6,320,776

The accompanying notes are an integral part of these financial statements.

NAVIGATOR TELECOMMUNICATIONS, LLC

Statements of Operations

For the Years Ended December 31, 2006 and 2005

	2006	2005
Telecommunications services revenue	$ 41,847,414	$ 36,812,757
Cost of telecommunications revenue	33,322,641	26,017,852
Gross profit	8,524,773	10,794,905
Operating expenses		
Selling, general and administrative	9,488,630	10,554,068
Depreciation	147,122	241,301
Abandonment of property and equipment	-	1,543,298
Total operating expenses	9,635,752	12,338,667
Loss from operations	(1,110,979)	(1,543,762)
Other income (expense)		
Interest income	64,673	7,591
Interest expense		
Cash	(946,074)	(571,344)
Non-cash	-	(1,511,750)
Amortization of loan fees	(126,810)	(22,568)
Total other income (expense), net	(1,008,211)	(2,098,071)
Net loss	$ (2,119,190)	$ (3,641,833)

The accompanying notes are an integral part of these financial statements.

NAVIGATOR TELECOMMUNICATIONS, LLC

Statements of Members' Deficit

For the Years Ended December 31, 2006 and 2005

	Membership Units	Members' Deficit
Balance - January 1, 2005	5,560,786	$ (7,767,280)
Conversion of debt to membership units	738,202	1,845,504
Anti-dilution units issued	15,188	-
Buyout of membership units	(836,221)	(1,575,000)
Net loss	-	(3,641,833)
Balance - December 31, 2005	5,477,955	(11,138,609)
Issuance of membership units	725,000	1,500,000
Anti-dilution units issued	1,477	-
Exchange of units for contribution allowances	99,791	-
Contribution allowances granted and vested	-	-
Membership unit rights vested	-	-
Net loss	-	(2,119,190)
Balance - December 31, 2006	6,304,223	$ (11,757,799)

Members' Equity		Total
Contribution Allowances	Membership Unit Rights	Members' Deficit
$ -	$ -	$ (7,767,280)
-	-	1,845,504
-	-	-
-	-	(1,575,000)
-	-	(3,641,833)
-	-	(11,138,609)
-	-	1,500,000
-	-	-
-	-	-
34,881	-	34,881
-	649	649
-	-	(2,119,190)
$ 34,881	$ 649	$ (11,722,269)

The accompanying notes are an integral part of these financial statements.

Statements of Cash Flows

For the Years Ended December 31, 2006 and 2005

	2006	2005
Cash flows from operating activities		
Net loss	$ (2,119,190)	$ (3,641,833)
Adjustments to reconcile net loss to net cash provided (used) by operating activities		
Depreciation	147,122	241,301
Loss on abandonment of property and equipment	-	1,543,298
Accretion of discount on notes payable	-	1,511,750
Contribution allowances granted and vested	34,881	-
Membership unit rights vested	649	-
Changes in operating assets and liabilities		
Trade accounts receivable	432,352	(595,090)
Prepaid expenses and other current assets	(304,772)	(400,517)
Trade accounts payable	428,125	1,860,931
Deferred revenue	146,674	224,215
Accrued liabilities	629,381	186,319
Customer deposits	(72,063)	(77,265)
Net cash provided (used) by operating activities	(676,841)	853,109
Cash flows from investing activities		
Purchases of property and equipment	(87,448)	(126,412)
Decrease (increase) in restricted cash	(40,000)	190,000
Net cash provided (used) by investing activities	(127,448)	63,588
Cash flows from financing activities		
Payment of membership unit repurchase obligation	(1,575,000)	-
Proceeds from issuance of membership units	1,500,000	-
Borrowings on bank line of credit	3,000,000	-
Payments on notes payable	(2,105,080)	(746,363)
Net cash provided (used) by financing activities	819,920	(746,363)
Net increase in cash	15,631	170,334
Cash - beginning of year	312,137	141,803
Cash - end of year	$ 327,768	$ 312,137

The accompanying notes are an integral part of these financial statements.

Notes to Financial Statements

December 31, 2006 and 2005

1. **Summary of Significant Accounting Policies**

a. **Organization** – Navigator Telecommunications, LLC (the "Company"), is an Arkansas limited liability company, organized on September 9, 1997. The business purpose of the Company is to operate as a reseller/provider of switched local exchange service and long distance service as a competitive local exchange carrier ("CLEC"). The Company is licensed to provide telephone services in 30 states and had approximately 91,000 and 88,000 lines in service at December 31, 2006 and 2005, respectively.

b. **Revenue recognition** – Both toll service revenues and local service revenues are recognized when earned regardless of the period in which they are billed. The Company has participated with Sprint, several Bell Operating Companies and other toll carriers in furnishing local and long distance telephone services.

c. **Cash and cash equivalents** – The Company considers all demand deposits and highly liquid investments with original maturities of three months or less to be cash equivalents.

Cash paid for interest amounted to $930,690 and $536,851 for the years ended December 31, 2006 and 2005, respectively.

Non-cash transactions consisted of the following:

	2006	2005
Purchase of insurance with note payable	$ 74,045	$ 83,582
Purchase of property and equipment with note payable	-	60,000
Accretion of discount of notes payable	-	1,511,750
Redemption of note payable in exchange for the issuance of membership units	-	1,845,504
Obligation to repurchase membership units	-	1,575,000

d. **Restricted cash** – Restricted cash consists of cash that is restricted as to future use by contractual agreements with certain states.

e. **Trade accounts receivable** – In the normal course of business, the Company extends credit to its customers on a short-term basis. The Company reviews its customer accounts on a periodic basis and records a reserve for amounts that the Company feels will not be collected. Past due status is determined based upon contractual terms. Management uses significant judgment in estimating uncollectible amounts, considering such factors as current overall economic conditions, industry-specific economic conditions, historical customer performance, anticipated customer performance, and date of last payment. While management believes the Company's processes effectively address its exposure to doubtful accounts, changes in economic, industry or specific customer conditions may require adjustment to the allowance recorded by the Company.

1. **Summary of Significant Accounting Policies (cont.)**

f. **Telecommunication infrastructure and depreciation** – Telecommunication infrastructure is stated at cost. Depreciation is provided using accelerated depreciation methods which do not differ materially from that which would be recorded using a method acceptable under generally accepted accounting principles.

Listed below are the major classes of telecommunication infrastructure in service as of December 31:

	Years	2006	2005
Central office equipment	5 - 10	$ 60,000	$ 60,000
Leasehold improvement	15	70,361	70,361
Furniture and office equipment	5 - 7	175,378	145,723
General purpose computers	3 - 5	839,741	781,946
		$ 1,145,480	$ 1,058,030

g. **Long-lived assets** – The Company reviews the carrying value of long-lived assets for impairment whenever triggering events or changes in circumstances indicate that the carrying amounts of any asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the excess of the carrying amount over the fair value of the assets.

In 2005, the Company elected not to renew a contract to provide telecommunications services to certain multi-family housing locations. In conjunction with the expiration of this contract, management determined that it no longer had rights to certain wiring and buried cable. Accordingly, the Company recognized an impairment loss of $1,543,298, which represented the net book value of the abandoned assets. The impairment loss is recorded as a component of operating expenses in the accompanying statements of operations for the year ended December 31, 2005. Based upon management's assessment of the impairment indicators for the remaining assets, management determined that testing for impairment was necessary. However, upon testing, management determined that the expected future net cash flows to be generated from these assets exceeded the carrying value; therefore, no additional impairment losses had occurred in the fiscal years ended December 31, 2006 or 2005.

h. **Income taxes** – The Company is structured to be treated as a partnership for federal and state income tax purposes. As such, the Company's taxable income or loss flows through to its members. No income tax provision or benefits are recorded directly by the Company. Management is not aware of any course of action or series of events that have occurred that might adversely affect the Company's tax returns.

1. **Summary of Significant Accounting Policies (cont.)**

i. **Use of estimates** – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

j. **Recently issued accounting standards** – In May 2005, the Financial Accounting Standards Board ("FASB") issued statement of Financial Accounting Standards ("SFAS") No. 154, "Accounting Changes and Error Corrections." This statement replaces Accounting Principles Board Opinion No. 20, Accounting Changes, and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements", and changes the requirements for the accounting for and reporting of a change in accounting principle. This statement applies to all voluntary changes in accounting principles. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. The implementation of this pronouncement did not have a significant impact on the financial statements in the current year.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP"), and expands disclosures about fair value measurements. The Company's management does not anticipate that this pronouncement will have a significant impact on the financial statements.

k. **Reclassifications** – Certain reclassifications have been made to the 2005 amounts in order to conform to the 2006 presentation.

2. **Business Condition**

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the ordinary course of business. As shown in the accompanying financial statements, during the years ended December 31, 2006 and 2005, the Company had net losses of $2,119,190 and $3,641,833, respectively. During 2006 and 2005, the Company used $676,841 of cash in operations and generated $853,109 of cash from operations, respectively. The Company's ability to continue as a going concern is dependent upon its ability to generate sufficient cash flows to meet its obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitable operations.

Notes to Financial Statements

December 31, 2006 and 2005

3. Line of Credit

The Company opened a line of credit due October 10, 2007 with Bank of Texas, N.A with maximum borrowings at December 31, 2006 of $3,000,000. The line of credit is guaranteed by members of the Company. Interest is payable monthly at the prime rate set by BOK Financial Corporation less 0.25% or the maximum lawful rate in the state of Texas, whichever is less (8% at December 31, 2006). The outstanding balance on the line of credit was $3,000,000 at December 31, 2006.

4. Notes Payable

Notes payable consist of the following:

	2006	2005
Non-interest bearing advance; due on demand; unsecured.	$ 150,000	$ 150,000
18% note payable to i3Voice & Data, Inc.; monthly payments of principal and interest of $2,169; matures August 2008.	38,828	56,135
Notes payable to a finance company; unsecured; due in monthly installments; for financing of insurance premiums.	35,808	39,487
Note Payable to First Arkansas Valley Bank; secured by all assets of the Company and guaranteed by certain members; monthly interest of 7.0%; due February 8, 2006.	-	2,010,049
	224,636	2,255,671
Less current portion	206,501	2,216,843
Notes payable, long-term	$ 18,135	$ 38,828

Aggregate maturities of long-term notes payable during the years subsequent to December 31, 2006 are as follows:

Year Ending December 31,	
2007	$ 206,501
2008	18,135
Total	$ 224,636

5. Notes Payable – Related Parties

Notes payable – related parties consist of the following:

	2006	2005
Note payable to NavTel Partners, LLC; no interest through July 1, 2007, interest due monthly at 10% thereafter; principal payments of $83,333 due monthly beginning January 25, 2008; matures August 15, 2012.	$ 5,634,132	$ 5,634,132
12% notes payable to members; due on demand; unsecured.	145,000	145,000
	5,779,132	5,779,132
Less current portion	145,000	145,000
Notes payable - related party, long-term	$ 5,634,132	$ 5,634,132

Aggregate maturities of notes payable – related parties during the years subsequent to December 31, 2006 are as follows:

Year Ending December 31,	
2007	$ 145,000
2008	999,996
2009	999,996
2010	999,996
2011	999,996
Thereafter	1,634,148
Total	$ 5,779,132

NavTel Partners, LLC Note Payable

On May 15, 2003, the Company combined its notes payable to several lenders into a single promissory note payable to NavTel Partners, LLC (the "lender") in an amount of $2,590,566. Additional borrowings from the lender increased the principal balance to $3,885,066 at December 31, 2003. The note had a stated due date of December 31, 2003, but could be extended at the Company's option for two additional one-year periods; however, upon the second extension, the lender had the right to call the note. During 2003, the Company requested and was granted an extension of the maturity date of the note to December 31, 2004. During 2004, the Company requested and was granted an additional extension of the maturity date of the note to December 31, 2005. The note bore interest at 20% per year or part of a year on the highest amount outstanding during the year (the stated accrued interest). The note was secured by all of the assets of the Company. Under the terms of the

5. **Notes Payable – Related Parties (cont.)**

note, from the date of the first one year extension, each lender had the option to receive preferential interest equal to 100% of their principal portion of the note at maturity instead of the stated accrued interest. Unless the lender elected to receive preferential interest, the note principal and stated accrued interest was convertible into membership units at $2.50 per unit at any time prior to payment.

Management accounted for these obligations under the most conservative (from the Company's perspective) option available to the lenders, which was for the lender to receive payment of the preferential interest and principal at maturity rather than conversion of principal and stated accrued interest into membership units. Therefore, a beneficial conversion option was not recognized upon issuance of the note and, instead, the 100% preferential interest was recognized ratably as interest expense through accretion of the note to $7,770,132 over the period from May 15, 2003 through December 31, 2005.

On December 31, 2005, one of the lenders elected to convert its portion of the lender's note payable in the amount of $1,845,504, which included accrued interest at 20% compounded annually, to membership units at $2.50 per unit, or 738,202 units. As discussed above, the Company had historically accounted for this obligation using the lender option that resulted in the most conservative accounting treatment. Accordingly, in conjunction with the lender's election to convert its portion of the NavTel Partners, LLC note payable to membership units, the Company recognized a reduction of previously recorded interest expense of approximately $290,000.

On December 31, 2005, the Company also entered into a Renewed, Amended, and Restated Secured Convertible Promissory Note with the lender for the remaining liability in the amount of $5,634,132. Under the terms of the amended note, no interest accrued prior to August 16, 2006, after which interest was to accrue at 10% and was to be due monthly. Monthly principal payments of $83,333 were to begin on January 25, 2007. Additionally, any capital raised by the Company after February 1, 2006 was to be paid to the lender and beginning in 2007, 50% of the Company's Excess Cash Flow, as defined in the agreement, was to be paid to the lender.

On October 10, 2006, the Company entered into Amendment No. 1 to the Renewed, Amended, and Restated Secured Convertible Promissory Note with the lender for the remaining liability in the amount of $5,634,132. Under the terms of the amended note, no interest will accrue prior to July 1, 2007, after which interest will accrue at 10% and will be due monthly. Monthly principal payments of $83,333 begin on January 25, 2008. Additionally, any capital raised by the Company after February 1, 2006 is to be paid to the lender, subordinated to the October 10, 2006 Bank of Texas line of credit, and beginning in 2007, 50% of the Company's excess cash flow, as defined in the agreement, is to be paid to the lender, subordinated to the October 10, 2006 Bank of Texas line of credit (Note 3). All remaining unpaid principal and interest shall be paid on August 15, 2012. In the event of default by the Company, the amended note shall bear interest at 25%. The note principal is convertible into membership units at $2.50 per unit at any time prior to payment.

Notes to Financial Statements

December 31, 2006 and 2005

6. Leases

The Company leases its offices under an operating lease which expires in July 2009. The Company also leases certain office equipment under operating leases which expire through 2010. Lease expense was $172,729 and $177,746 during the years ended December 31, 2006 and 2005, respectively. The following is a schedule of minimum lease payments at December 31, 2006:

Year Ending December 31,	
2007	$ 173,869
2008	179,461
2009	116,671
2010	21,070
Total	$ 491,071

7. Members' Equity

On December 31, 2005, one of the lenders elected to convert its portion of the NavTel Partners, LLC note payable in the amount of $1,845,504 to membership units at $2.50 per unit, or 738,202 units (See Note 5). During 2006, the Company purchased all of the outstanding membership units owned by the lender, or 836,221 units, for $1,575,000, consisting of $1,500,000 in cash and $75,000 in a note payable.

On January 3, 2006, the Company issued 100,000 membership units to a member at $2.50 per unit for cash. Additionally, on January 18, 2006, the Company issued 625,000 membership units to a customer at $2.00 per unit for cash. See Note 9 for further information related to this issuance.

During 2006 and 2005, the Company issued 1,477 and 15,188 membership units, respectively, pursuant to the terms of anti-dilution agreements with two members which own 301,959 and 300,482 membership units or 4.8% and 5.2% of the Company's outstanding membership units at December 31, 2006 and 2005, respectively. Under the terms of the agreements, these members receive additional units to the extent that the Company sells units for less than $4.25 per unit.

SFAS No. 123R addresses the accounting for share-based payment transactions in which a company receives goods or services in exchange for (a) equity instruments of the company or (b) liabilities that are based on the fair value of the company's equity instruments or that may be settled by the issuance of such equity instruments. SFAS No. 123R focuses primarily on accounting for transactions in which a company obtains "employee" services in share-based payment transactions. The statement eliminates the ability to account for share-based compensation transactions using Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees," and generally requires that such transactions be accounted for using a fair value based method. Accordingly, pro forma disclosure is no longer an alternative.

7. **Members' Equity (cont.)**

SFAS No. 123R, requires the recognition of compensation cost for the portion of outstanding awards previously accounted for under the provisions of APB No. 25 for which the requisite service had not been rendered as of the adoption date for this statement. The statement also requires companies to estimate forfeitures of stock compensation awards as of the grant date of the award. Pre-vesting forfeitures were estimated to be 25% based on management's current expectations.

SFAS No. 123R permits nonpublic companies that used the fair-value method for either recognition or pro forma disclosure under SFAS No. 123 to adopt its requirements using one of the following two methods:

- A "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date;

- A "modified retrospective" method, which includes the requirements of the modified prospective method described above, but also permits entities to restate, based on the amounts previously recognized under SFAS No. 123 for purposes of pro forma disclosures, either (a) all prior periods presented for which SFAS No. 123 was effective or (b) prior interim periods of the year in which SFAS No. 123R is adopted.

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123R using the modified prospective method. Upon adoption of SFAS No. 123R, the Company elected to continue to value its share-based payment transactions using a Black-Scholes valuation model, which was previously used by the Company for purposes of preparing the pro forma disclosures under SFAS No. 123. Compensation expense for share-based awards granted after January 1, 2006 are expensed using a straight-line single option method, which is the same attribution method that was used by the Company for purposes of its pro forma disclosures under SFAS No. 123. The effect of adopting SFAS No. 123R resulted in compensation expense for share-based awards of $35,530 for the year ended December 31, 2006 and is included in selling, general and administrative expenses in the accompanying statements of operations.

Prior to adopting the provisions of SFAS No. 123R, the Company recorded estimated compensation cost for share-based awards based upon the intrinsic value of the award on the date of grant consistent with the recognition and measurement principles of APB Opinion No. 25. Because the Company had established exercise prices of its share-based awards at or above the fair market value of the related shares at the date of grant, the share-based awards had no intrinsic value upon grant and, accordingly, the Company did not record compensation expense for share-based awards prior to adopting SFAS No. 123R.

At December 31, 2006, the members held outstanding contribution allowance agreements ("allowances") that will allow them to purchase additional membership units at a specified price per share (ranging from $0.01 to $6.00 per unit) which expire during 2007 through 2011.

7. **Members' Equity (cont.)**

A summary of the status of these allowances at December 31, 2006 and 2005 and changes during the years then ended is presented in the table below:

	2006		2005	
	Units	Weighted - Average Exercise Price	Units	Weighted - Average Exercise Price
Outstanding at beginning of year	2,336,916	$ 3.79	2,352,751	$ 3.84
Granted	268,811	2.59	25,000	3.00
Repurchased with units	(1,496,880)	3.75	-	-
Expired	(434,581)	4.03	(40,835)	6.00
Oustanding at end of year	674,266	$ 2.52	2,336,916	$ 3.79
Exercisable at end of year	674,266	$ 2.52	2,336,916	$ 3.79

The weighted-average fair value of allowances granted during the year ended December 31, 2006 was $0.17. The fair value of each allowance grant was estimated on the date of grant using the Black-Scholes Option-Pricing model with the following weighted-average assumptions used for the year ended December 31, 2006: risk free interest rate of 4.75%; expected dividend yield of zero; expected life of 5 years; and no expected volatility.

During 2006, the Company repurchased 1,496,880 allowances, which represent all of the outstanding allowance that had been issued for debt guarantees at a $0.20 per allowance in exchange for an issuance of 99,791 membership units at $3.00 per unit.

The following table summarizes information about the allowances outstanding at December 31, 2006:

	Contribution Allowances Oustanding and Exercisable		
Range of Exercise Prices	Allowances Outstanding	Weighted - Average Remaining Contractual Life	Weighted - Average Exercise Price
$ 0.01	266,766	0.63 years	$ 0.01
2.00	110,000	4.52 years	2.00
3.00	25,000	3.36 years	3.00
5.00	235,000	1.17 years	5.00
6.00	37,500	0.23 years	6.00
$0.01 - $6.00	674,266	1.53 years	$ 2.52

Notes to Financial Statements

December 31, 2006 and 2005

7. **Members' Equity (cont.)**

The Company sponsors membership unit appreciation plans for its management and employees. In consideration for the employees' continued services, the Company grants the employees certain rights to share in the appreciation of the value of the Company's membership units in the event the Company is sold. Key employees vest in these rights over three years and these rights expire 18 months after termination. Non-key employees vest in these rights immediately and these rights expire upon termination. The unit appreciation right entitles an employee to receive the excess of the fair market value of a unit over an established unit value at the employee's date of grant, in the event of the sale of the Company. The initial rights granted to a member of management, or an employee, are based on their position with the Company. These rights are unsecured.

A summary of the status of the membership unit rights granted to management and employees at December 31, 2006 and 2005 and changes during the years then ended is presented in the tables below:

	2006		2005	
	Units	Weighted - Average Exercise Price	Units	Weighted - Average Exercise Price
Outstanding at beginning of year	566,300	$ 4.00	774,500	$ 4.00
Expired	23,800	4.00	208,200	4.00
Oustanding at end of year	542,500	$ 4.00	566,300	$ 4.00
Exercisable at end of year	542,500	$ 4.00	561,300	$ 4.00

No membership unit rights were granted in 2006 or 2005. The following table summarizes information about the membership unit rights outstanding at December 31, 2006:

	Membership Unit Rights Outstanding		Membership Unit Rights Exercisable	
Range of Exercise Price	Number of Rights Outstanding	Weighted- Average Exercise Price	Number of Rights Exercisable	Weighted- Average Exercise Price
$ 4.00	542,500	$ 4.00	542,500	$ 4.00

Notes to Financial Statements

December 31, 2006 and 2005

8. Commitments

The Company has executed various agency agreements for the marketing and sale of its services. The agreements typically cover an initial five year period. The terms generally provide for automatic one year renewals unless terminated by either party with not less than 60 days notice. In return, the Company pays the agent a monthly marketing and sales commission based on a percentage of its collected revenue from its sale of services to customers. Total commissions for the years ended December 31, 2006 and 2005 amounted to $2,009,823 and $2,184,733, respectively.

9. Warrant Agreement with Significant Customer

The Company entered into a telecommunications services agreement dated October 10, 2005 with a large customer which has operations across the United States (the "Customer"). Revenues earned from the Customer during 2006 and 2005 approximated 9% and 5%, respectively, of total revenues, and management expects the dollar revenues from the Customer to increase in future periods. In conjunction with entering into this service agreement, the Company entered into a separate agreement in which it issued warrants to the Customer to purchase up to 1,853,595 membership units at $3 per unit, based upon certain terms and conditions over a three year period. The Company agrees to reserve for issuance the number of warrants subject to exercise under this agreement.

As of the date of these financial statements, none of the warrants issued to the Customer had been exercised. However, in January 2006, the Customer did purchase 625,000 membership units. This purchase did not reduce the number of units which can be purchased pursuant to the warrant agreement discussed above. The proceeds from this sale were used to fund the repurchase of the membership units as discussed in Note 7 above.

Due to the short duration of the window of time to exercise the warrants pursuant to this agreement and the uncertainty of the number of warrants which may ultimately become exercisable, the Company has not given accounting recognition to these warrants.

10. Telephone Industry Regulations

On December 15, 2004, the Federal Communications Commission (the "Commission") adopted new rules for the network unbundling obligations of incumbent local phone carriers ("ILECs"), in response to the March 2, 2004 decision by the U.S. Court of Appeals for the Washington, D.C. Circuit overturning portions of the Commission's August 21, 2003 Triennial Review Order. The Commission released its Order with the new rules on February 4, 2005. The new rules took effect on March 11, 2005. The new rules provide that ILECs have no legal obligation to provide CLECs with unbundled access to mass market local circuit switching ("UNE-P"). The ILECs have provided UNE-P access through commercial agreements.

10. **Telephone Industry Regulations (cont.)**

The Company has taken a number of measures to ensure a smooth transition from its UNE-P strategy. The Company has executed commercial and interconnection agreements with each of its ILEC's and multiple non-ILEC suppliers in current and expanding markets. Additionally, the Company continues to evaluate and explore the availability of switching and services provided by other suppliers, as well as other emerging technologies and applications such as Voice over Internet Protocol ("VoIP").

Although the effect of these changes had a detrimental impact on the cost of providing its services, the Company continues to believe that its strategy will achieve sustainable profitable operations.

11. **Concentrations of Credit Risk**

Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of telecommunication accounts receivable with a variety of customers and cash deposited with financial institutions. The Company generally does not require collateral from its customers. Such credit risk is considered by management to be limited due to the Company's broad customer base and its customers' financial resources.

At December 31, 2006 and 2005 and at various times throughout these years, the Company maintained cash balances with certain financial institutions in excess of the federal deposit insurance limit. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any unusual credit risk beyond the normal credit risk associated with commercial banking relationships.